

SURREBUTTAL TESTIMONY AND EXHIBIT OF
DAWN M. HIPPI
ON BEHALF OF
THE SOUTH CAROLINA OFFICE OF REGULATORY STAFF
DOCKET NO. 2021-324-WS

1 **Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS, AND OCCUPATION.**

2 A. My name is Dawn M. Hipp. My business address is 1401 Main Street, Suite 900,
3 Columbia, South Carolina 29201. I am employed by the State of South Carolina as the
4 Chief Operating Officer of the Office of Regulatory Staff (“ORS”).

5 **Q. DID YOU FILE DIRECT TESTIMONY AND FOUR (4) EXHIBITS RELATED**
6 **TO THIS PROCEEDING?**

7 A. Yes, I filed Direct Testimony and four (4) exhibits with the Public Service
8 Commission of South Carolina (“Commission”) on February 24, 2022.

9 **Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?**

10 A. The purpose of my Surrebuttal Testimony is to respond to the Rebuttal Testimony
11 of Kiawah Island Utility, Inc. (“KIU” or “Company”) Witnesses Sorenson, Nicholson, and
12 Hafeez. Specifically, my Surrebuttal Testimony responds to the following topics:

13 1) Witness Sorenson’s characterization of ORS’s mission and discussion related to the
14 Secondary Pipeline Project.

15 2) Witness Nicholson’s assertion that the \$2.4 million settlement (“Mears
16 Settlement”) with Mears Group, Inc. (“Mears”) is reasonable, prudent and a cost
17 that the KIU customers should pay fully.

3) Witness Hafeez's claims related to the recovery of allocated costs from KIU's parent entity, SouthWest Water Company ("SWWC"), in the areas of executive compensation and the Corporate Development Team ("Team").

To the extent I do not specifically address a statement made in any of the Company's Rebuttal Testimony that should not be construed as an agreement with any positions I do not address.

Response to the Company's Rebuttal - ORS Mission

Q. PLEASE RESPOND TO COMPANY WITNESS SORENSON'S REBUTTAL TESTIMONY CHARACTERIZING ORS'S REVENUE RECOMMENDATIONS AS NOT FULFILLING ORS'S MISSION (SORENSEN REBUTTAL TESTIMONY PAGES 2 AND 3).

A. As stated in my Direct Testimony, ORS represents the public interest as defined by the South Carolina General Assembly in S.C. Code Ann. § 58-4-10(B) (Supp. 2020) as follows:

[T]he concerns of the using and consuming public with respect to public utility services, regardless of the class of customer, and preservation of continued investment in and maintenance of utility facilities so as to provide reliable and high-quality utility services.

Witness Sorensen states that ORS's revenue requirement recommendation "does not **promote** continued investment in utility facilities." Witness Sorensen interchanges "promote" for the word used in S.C. Code Ann. § 58-4-10(B), "preservation." The wording interchange materially alters the meaning of the sentence and ORS's statutory responsibilities.

ORS's representation of the public interest requires it to make recommendations that preserve continued investment in and maintenance of utility services; that is, ORS's

recommendations must keep investment and maintenance alive, intact, or free from degradation. ORS strongly disagrees with the Company's testimony to the extent that it implies or suggests that the mission of ORS is to promote the financial growth of the Company, to increase customer rates to necessarily align with current inflation levels, and to recommend the Company have an opportunity to earn a return on equity greater than necessary to preserve continued investment in and maintenance of utility facilities. Notably, the Company does not identify specific negative outcomes directly attributed to ORS's revenue requirement recommendation.

In this case, ORS's recommendations carry out its statutory public interest mission. ORS's recommendations reflect that KIU customers' rates should only be based on the actual cost for the provision of reliable, high-quality water and sewer service and a return that is adequate to maintain its credit and attract capital.

Response to the Company's Rebuttal - \$2.4 million Mears Settlement

Q. PLEASE SUMMARIZE WITNESS SORENSEN'S REBUTTAL TESTIMONY RELATED TO THE \$2.4 MILLION MEARS SETTLEMENT (SORENSEN REBUTTAL TESTIMONY PAGES 6-10).

A. In summary, KIU Witness Sorensen asserts in Rebuttal Testimony that:

1) The Mears Settlement costs paid by KIU represent real costs that were incurred to complete the Secondary Pipeline Project.¹

2) The Company was forced to rely on the decision-making of Mears.²

¹ Rebuttal Testimony of Craig Sorensen p.8, ll.8-9

² Rebuttal Testimony of Craig Sorensen p.7, ll.15-17

3) The Company performed adequate risk mitigation on the Secondary Pipeline Project.³

4) The Company's decision to settle continued litigation was in the balanced interest of its customers and the Company.⁴

I will address each of Witness Sorenson's assertions in turn.

Q. DID ORS DETERMINE THAT THE \$2.4 MILLION MEARS SETTLEMENT WAS BASED ON REAL COSTS THAT WERE INCURRED BY KIU TO COMPLETE THE SECONDARY PIPELINE PROJECT?

A. No. As stated in my Direct Testimony, the Company's records indicate the \$2.4 million reflects a Fixed Asset Acquisition described as "Mears Settlement." KIU did not provide ORS with itemized invoices from Mears to support the Company's assertion in Rebuttal Testimony that the \$2.4 million corresponds to identified real costs for expenses related to the second drill. Therefore, the Company's claim that the \$2.4 million Mears Settlement is used and useful is unsupported and cannot be verified by ORS.

Q. WITNESS SORENSEN INDICATES COMPLETION OF THE SECONDARY PIPELINE PROJECT REQUIRED \$7 MILLION IN ADDITIONAL CAPITAL INVESTMENT (SORENSEN REBUTTAL TESTIMONY PAGE 7). DID THE COMPANY PROVIDE SUPPORTING DOCUMENTATION INCLUDING INVOICES FOR \$7 MILLION IN ADDITIONAL CAPITAL INVESTMENTS ABOVE THE APPROXIMATELY \$9.75 MILLION CURRENTLY INCLUDED IN CUSTOMER RATES?

³ Rebuttal Testimony of Craig Sorensen p.8, ll.11-20

⁴ Rebuttal Testimony of Craig Sorensen p.10, ll.1-14

1 A. No. KIU did not provide ORS with itemized invoices from Mears to support that
2 an additional \$7 million in expenses were incurred by the Company as “real” costs for
3 expenses related to the second drill. Witness Sorensen refers to “[t]he Contractor’s claim
4 by item and dat[e]” but does not provide the Contractor’s specific claim information in his
5 Rebuttal Testimony or exhibits. It appears Witness Sorensen refers to Civil Action 2:17-
6 cv-02418-DCN (“Civil Action”) in the U.S. District Court of the District of South Carolina,
7 Charleston Division (“Federal District Court”) in which Mears sued KIU for breach of
8 contract. The judge in that action ruled that the contract between Mears and KIU
9 “[u]nambiguously requires KIU to obtain primary builders risk insurance and grant[ed]
10 summary judgement as to Mears’s declaratory judgement claim.”⁵

11 While ORS did not review every public record in the civil action, ORS did review
12 a copy of the Official Transcript of the Motions for Summary Judgement dated January 16,
13 2019. See Surrebuttal Exhibit Hipp-1. During the oral arguments on the Motion, KIU’s
14 attorney acknowledged the Mears claim for \$7 million to replace a portion of the pipe but
15 could not explain how the \$7 million loss exceeds the \$5 million estimated project. KIU’s
16 attorney indicated the \$7 million claim amount will be reviewed as part of discovery.⁶ If
17 the Company received documentation to support the Mears claim of \$7 million, it has not
18 provided to ORS the details of the additional expenses in this rate case proceeding. The
19 Company is a regulated utility, and the recovery of its spending from customers is subject
20 to review by this Commission; therefore, it remains the Company’s responsibility to
21 provide documentation to support the request for rate increase.

⁵ See Direct Testimony Dawn M. Hipp Exhibit Hipp-2 page 9.

⁶ Surrebuttal Exhibit Hipp-1 p. 22 ll.3-18

Witness Sorensen also testified in Rebuttal Testimony that “the permit to operate would never have been issued without the additional costs being spent[.]”⁷ Currently, KIU customers rates reflect the Company’s total investment of \$9,742,848.83 for the Secondary Pipeline. According to the Company’s own Direct Testimony in Docket No. 2016-222-WS, KIU received its permit to operate the Secondary Pipeline in February 2017 based on the expenses incurred and recovered through customer’s current rates.⁸ It is unclear how the \$2.4 million Mears Settlement, paid in 2021, factored into the issuance of the permit to operate. The Company’s assertion that the \$2.4 million represents real costs incurred for the Secondary Pipeline Project is unsupported.

Q. PLEASE RESPOND TO WITNESS SORENSEN’S ASSERTION THAT THE COMPANY “WAS FORCED TO ALSO RELY ON THE DECISION-MAKING OF THE CONTRACTOR” WHEN IT HAD TO DRILL A SECOND TIME TO COMPLETE THE SECONDARY PIPELINE PROJECT. (SORENSEN REBUTTAL PAGE 7 LINES 15-17).

A. The Company asserted that the horizontal directional drilling (“HDD”) technology required the Company to rely on Mears for planning, design, and execution related to the longest HDD section of the Secondary Pipeline Project. The Rebuttal Testimony of Witness Sorensen implied that the decision-making actions related to the second drill rested with Mears. It is not reasonable or prudent for the Company to delegate away all decision-making authority to a third-party and insulate itself from oversight of and responsibility for the additional costs incurred on the Secondary Pipeline Project. If KIU were permitted to

⁷ Rebuttal Testimony of Craig Sorensen, p. 7, ll. 3-5.

⁸ Docket No. 2016-222-WS Direct Testimony of Becky Dennis p.5.

1 pass along the additional costs of the \$2.4 million Mears Settlement to its customers, KIU
2 would not be incentivized to minimize costs.

3 **Q. PLEASE RESPOND TO WITNESS SORENSEN’S ASSERTION THAT THE**
4 **COMPANY WAS “FINANCIALLY COVERED” IN THE FINAL CONTRACT**
5 **WITH MEARS (SORENSEN REBUTTAL PAGES 8-9).**

6 A. The Company signed the HDD contract with Mears on January 7, 2016. The Mears
7 contract was signed by Jordan Phillips, a representative of the then-parent Company of
8 KIU, KIU Holdings, LLC. SWWC acquired the membership holdings of KIU Holdings,
9 LLC on March 9, 2016. Given that SWWC did not acquire KIU until two months after the
10 execution of the Mears contract, it is unclear how Witness Sorensen can speak with
11 authority about the obligation reviews performed by KIU and KIU Holdings, LLC. before
12 KIU signed the contract with Mears.

13 In Rebuttal Testimony, the Company offers sections from the Mears Contract as
14 support for its original position that KIU was not required to procure the primary builders
15 risk insurance coverage for the Secondary Pipeline Project. However, the Company
16 acknowledges that the Federal District Court ruled unambiguously that the Company was
17 obligated to procure the primary builders risk insurance coverage under the Mears
18 Contract. The Company’s Rebuttal Testimony does not square with the Federal District
19 Court Order on the subject of procurement of insurance. The Company cannot, in this
20 proceeding, re-litigate the Civil Action and the Federal District Court’s Order in which
21 Mears sued KIU for breach of contract. KIU lost when the judge ruled that the contract
22 between Mears and KIU “[u]nambiguously requires KIU to obtain primary builders risk
23 insurance and grant[ed] summary judgement as to Mears’s declaratory judgement claim.”

1 Simply stated, KIU did not fulfill all obligations to mitigate the risks to customers
2 of the Secondary Pipeline Project. The Company is unable to point to the specific steps of
3 the KIU obligation review, which appears to have been performed by KIU and KIU
4 Holdings, LLC. Further, the Company relies on Witness Sorensen's Rebuttal Testimony
5 Exhibit 3 dated November 15, 2015,⁹ which points to a comment bubble from contract
6 negotiations to support the Company's assertion that KIU performed all reasonably
7 necessary reviews to understand and mitigate the risks from a potential loss on the
8 Secondary Pipeline Project. The information offered by the Company was rejected in
9 Federal District Court and does not support the Company's assertion that KIU took all
10 reasonably necessary actions to assess, respond to, and mitigate risk, to procure necessary
11 insurance and minimize costs for its customers.

12 **Q. PLEASE RESPOND TO WITNESS SORENSEN'S ASSERTION THAT THE**
13 **COMPANY MADE REASONABLE AND PRUDENT EFFORTS TO MINIMIZE**
14 **THE FINANCIAL IMPACTS (SORENSEN REBUTTAL PAGES 10).**

15 A. The Company's assertion that the \$2.4 million Mears settlement was prudent
16 appears to be based on the premise that the \$7 million of unverified costs claimed by Mears
17 for the second drill and the litigation costs incurred by the Company are the financial
18 responsibility of its ratepayers. The premise is flawed from a regulatory perspective
19 because the Company ignores the fact that, as a regulated utility, the recovery of
20 Company's costs from customers are subject to review by this Commission. The

⁹ Rebuttal Testimony of Craig Sorensen Exhibit 3 is not labelled. Based on its review, ORS understands that this document was submitted by KIU to the Federal District Court as part of KIU's Opposition to Mears' Motion for Partial Summary Judgment.

Commission must review and consider the relevant management and legal factors before it determines whether the expenses are recoverable from the KIU customers.

The management and legal factors include: 1) a valid and final Federal District Court order ruled that the Company breached its contract with Mears by not procuring primary builders risk insurance; 2) protracted litigation with Mears and the insurers; and, 3) the negotiated settlement agreement that required KIU to pay Mears \$2.4 million. KIU should not be allowed to insulate its shareholders/owners from the financial outcomes that resulted from Company management actions. Customers are not a financial backstop for management decisions that lead to uneconomic outcomes. ORS's recommendation to disallow the \$2.4 million attributed to KIU's Mears Settlement payment aligns management performance with customer interests to encourage and promote careful assessment of the risk of financial loss and the cost impacts to customers of project construction.

Q. PLEASE SUMMARIZE WITNESS NICHOLSON'S REBUTTAL TESTIMONY RELATED TO THE \$2.4 MILLION MEARS SETTLEMENT.

A. In summary, KIU Witness Nicholson asserts in Rebuttal Testimony that:

- 1) The Mears Settlement is used and useful as the payment was required to settle litigation.¹⁰
- 2) The Company took reasonable and prudent steps to mitigate risks.¹¹
- 3) ORS's position is not a realistic view of the "real world" and would lead to risky business decisions harmful to customers.¹²

¹⁰ Rebuttal Testimony of Benjamin Nicholson p.7, ll.3-6

¹¹ Rebuttal Testimony of Benjamin Nicholson p.7, ll.7-10

¹² Rebuttal Testimony of Benjamin Nicholson p.7, ll.11-16

1 **Q. PLEASE RESPOND TO WITNESS NICHOLSON’S TESTIMONY REGARDING**
2 **THE REGULATORY CONCEPT OF USED AND USEFUL.**

3 A. KIU does not operate in a competitive environment and KIU’s customers cannot
4 change water and sewer providers. Therefore, the Commission serves a very important role
5 to protect both KIU customers from unreasonable costs and allow KIU the opportunity to
6 earn a fair return on prudent, used, and useful investments. The general ratemaking
7 standards that guide expense recovery for a regulated utility such as KIU include the
8 following determinations by the Commission:

9 1) The operating expense is reasonable, prudent, and necessary for the provision of
10 utility service.

11 2) The asset is used and useful, in service, and provides benefit to the customer.

12 The Commission’s potential disallowance of utility costs or assets through the ratemaking
13 process is a strong motivation for a regulated utility to act in a prudent manner.

14 **Q. PLEASE RESPOND TO WITNESS NICHOLSON’S ASSERTION THAT ORS’S**
15 **RECOMMENDATION REQUIRES THE COMPANY TO OPERATE UNDER A**
16 **STANDARD OF PERFECTION (NICHOLSON REBUTTAL PAGE 9 LINES 9-13).**

17 A. The Company asserts that ORS’s recommendation to exclude from ratemaking the
18 \$2.4 million attributed to the Mears Settlement does not reflect the “real world” of
19 construction.¹³ However, Witness Nicholson’s Rebuttal Testimony ignores the concern
20 raised by ORS that the Company did not fully assess, understand, or take the necessary
21 steps to protect itself or its customers from reasonably foreseeable sources of financial loss
22 when it executed the Mears contract in January 2016. As stated in my Direct Testimony,

¹³ Rebuttal Testimony of Benjamin Nicholson p.8, ll.14-16

the fact that the Secondary Pipeline Project could experience a loss was a known and understood risk. Witness Nicholson offers no information to demonstrate that KIU management took all reasonable and necessary steps before or after the signing of the Mears contract to secure additional insurance coverage.

Instead, several years after having to perform a second drill at increased cost and protracted litigation, the Company effectively asserts that “real world” construction is complex and imperfect, the additional \$2.4 million is a cost of doing business, and the costs of doing business are the full responsibility of customers. KIU management did not take all reasonably necessary steps to identify and address potential and foreseeable losses involving the Secondary Pipeline Project as evidenced by the final, unvacated ruling of the Federal District Court. Perfection and undertaking all reasonably necessary steps to prepare for a complex construction project are two very different things.

Q. DOES WITNESS NICHOLSON ACCURATELY CHARACTERIZE ORS’S POSITION ON WHETHER THE BUILDERS RISK INSURANCE WOULD HAVE MITIGATED THE RISK ASSOCIATED WITH THE FAILURE EXPERIENCED BY KIU AND MEARS (NICHOLSON REBUTTAL TESTIMONY PAGE 10 LINES 10-11)?

A. No. Witness Nicholson does not accurately characterize ORS’s position in Rebuttal Testimony. ORS did not speculate on whether builders risk insurance would have extended coverage to the damages claimed by Mears, nor did ORS speculate on the likelihood of coverage by KIU or Mears other insurers. KIU’s request to recover the \$2.4 million Mears Settlement from its customers treats the Company’s customers themselves as an

“insurance” policy by transferring the financial risk of the losses associated with the Secondary Pipeline Project to customers.

Q. PLEASE RESPOND TO WITNESS NICHOLSON’S ANALYSIS OF THE LAWSUITS INVOLVING KIU, MEARS, AND THE INSURERS (NICHOLSON REBUTTAL TESTIMONY PAGES 10-14).

A. In Witness Nicholson’s analysis of the insurer litigation, the Mears litigation and the Mears Settlement, Witness Nicholson opines about actions that may have been taken by the parties to the lawsuits, possible expenses incurred by KIU, and possible outcomes based on his experience in the construction insurance field. However, Witness Nicholson’s testimony is focused on the Company’s decision to settle. Witness Nicholson does not discuss the process or information KIU relied upon to make the decision to execute the contract and without procuring the necessary insurance to mitigate the risk in connection with the Secondary Pipeline Project. In fact, Witness Nicholson states he disagrees with the Federal District Court’s order and that it would have been risky and a waste of resources to litigate further. This does not change the fact the Federal District Court’s order remains in place and was not vacated due to the Mears Settlement among parties. Nor does it show that customers should be fully responsible for the amount of KIU’s settlement payment to Mears.

Q. PLEASE RESPOND TO WITNESS NICHOLSON’S OPINION THAT ORS’S RECOMMENDATION TO DISALLOW THE \$2.4 MILLION ATTRIBUTED TO THE MEARS SETTLEMENT WOULD LEAD TO FUTURE RISKY BUSINESS DECISIONS HARMFUL TO CUSTOMERS (NICHOLSON REBUTTAL TESTIMONY PAGES 7, 15-16).

1 A. The Company has an ongoing regulatory duty to approach decisions with care,
2 caution, and good judgement, and respond to changing circumstances. Otherwise, the
3 Company risks disallowance of costs or assets during the ratemaking process. The ORS
4 recommendation to exclude \$2.4 million attributed to the Mears Settlement from rate base
5 encourages negotiation and thorough assessment of all future construction projects,
6 incentivizes the Company to take all reasonably necessary steps to understand the terms of
7 its agreements and the risks associated with them, and ultimately incentivizes the Company
8 to make all reasonable efforts to minimize costs.

9 **Q. PLEASE SUMMARIZE ORS'S POSITION RELATED TO THE RECOVERY OF**
10 **\$2.4 MILLION ATTRIBUTED TO A SETTLEMENT THE COMPANY REACHED**
11 **WITH ITS CONTRACTOR, MEARS.**

12 A. The ORS's recommendation to remove \$2.4 million recorded by the Company to
13 Gross Plant in Service, the corresponding depreciation expense, and the corresponding
14 accumulated depreciation, for ratemaking purposes is reasonable and consistent with
15 recognized regulatory principles. The \$2.4 million Mears Settlement does not represent
16 actual expenses that can be verified, or assets that are used or useful to customers. Further,
17 the Company did not fulfill its obligation to assess, understand or mitigate the foreseeable
18 financial risk associated with the Secondary Pipeline Project.

19 **Response to the Company's Rebuttal - Executive Compensation & Corporate Development**

20 **Q. PLEASE SUMMARIZE WITNESS HAFEEZ'S REBUTTAL TESTIMONY**
21 **RELATED TO THE COMPANY'S EXECUTIVE COMPENSATION AND**
22 **CORPORATE DEVELOPMENT TEAM.**

23 A. In summary, KIU Witness Hafeez asserts in Rebuttal Testimony that:

1 1) SWWC executives' duties are exactly aligned between shareholders/owners and
2 customers.¹⁴

3 2) The Company's adjustment to remove incentive compensation based on financial
4 performance is sufficient.¹⁵

5 3) The Corporate Development Team ("Team") yields net financial benefits to KIU
6 customers.¹⁶

7 I will respond to each of Witness Hafeez's assertions in turn.

8 **Q. PLEASE RESPOND TO WITNESS HAFEEZ'S ASSERTION THAT SWWC**
9 **EXECUTIVES' DUTIES ARE EXACTLY ALIGNED BETWEEN**
10 **SHAREHOLDER/OWNERS AND CUSTOMERS.**

11 A. A review of the SWWC executive position descriptions indicates the
12 responsibilities of SWWC executives are focused heavily on the financial performance and
13 profit optimization for shareholders/owners. For illustrative purposes only, a key word
14 analysis of the position descriptions of SWWC President & CEO, Chief Financial Officer
15 ("CFO"), Chief Operating Officer ("COO") and Vice President, General Counsel ("VP")
16 indicates the frequency with which the following words appear within each executive
17 position description.

¹⁴ Rebuttal Testimony of Mujeeb Hafeez p.3, ll.1-4

¹⁵ Rebuttal Testimony of Mujeeb Hafeez pp.4-8

¹⁶ Rebuttal Testimony of Mujeeb Hafeez pp.10-12

Table 1:
Word Frequency Analysis of SWWC Position Descriptions

Key Word Search	President & CEO	CFO	COO	VP
Stockholder Investor Value Board (of Directors) Profit Profitability Financial Return Merger Acquisition	23	36	5	1
Customer Efficient Quality Service Compliance	7	5	8	2

While the key word analysis is simplistic, the results highlight the focus and priorities of each executive position. Therefore, the Company's claim that SWWC executive management does not predominately focus on shareholder/owner interests is contradicted by the Company's position descriptions.¹⁷ Furthermore, with the exception of the COO, the other SWWC executive positions description do not require regular interaction with customers to any meaningful degree. Witness Hafeez's Rebuttal Testimony provides no specific evidence to support the SWWC executive team's achievements and associated benefits to customers. Nor does Witness Hafeez demonstrate

¹⁷ SWWC is owned by Infrastructure Investments Fund which is controlled by J.P. Morgan Chase, a publicly traded entity.

1 that the SWWC executive team seeks or maintains direct, one-on-one interactions with
2 customers.

3 As stated in my Direct Testimony, because executive compensation provides
4 benefits to both shareholders and customers, cost sharing is appropriate. Further, the
5 Commission has approved similar adjustments for large utilities with more complex
6 corporate structures and overhead allocations for expenses including salaries, benefits, and
7 associated taxes.

8 **Q. PLEASE RESPOND TO WITNESS HAFEEZ'S ASSERTION THAT THE**
9 **COMPANY'S ADJUSTMENT TO REMOVE INCENTIVE COMPENSATION**
10 **TIED TO FINANCIAL PERFORMANCE IS SUFFICIENT TO DEMONSTRATE**
11 **THAT COSTS SOLEY ATTRIBUTED TO SHAREHOLDER/OWNER VALUE**
12 **HAVE BEEN ELIMINATED FROM THE RATE REQUEST.**

13 A. The Commission has confirmed in multiple orders that incentive compensation tied
14 directly to the financial performance of the utility is not eligible for recovery from the
15 utility's customers.¹⁸ Specifically, incentive compensation expenses associated with
16 financial performance are not eligible for recovery because: 1) payments for financial goals
17 are not certain; 2) earnings can be influenced greatly by factors such as customer growth
18 and higher authorized returns that are not directly attributed to the actions of Company
19 employees; and 3) incentive payments to employees should be made using increased
20 earnings not through customer rates. Therefore, it is reasonable to expect that KIU

¹⁸ Docket No. 2019-6-G, Order No. 2019-729; Docket No. 2019-7-G, Order No. 2019-730; Docket No. 2020-6-G, Order No. 2020-701; Docket No. 2020-7-G, Order No. 2020-702, Order No. 702(A); Docket No. 2020-125-E, Order No. 2021-570; Docket No. 2021-6-G, Order No. 2021-663, Order No. 2021-663(A); Docket No. 2021-7-G, Order No. 2021-664.

voluntarily eliminated the corresponding amounts from the Company's Application.

In the very same Commission Orders that established the framework related to incentive compensation, the Commission also approved a cost sharing of the base salary, benefits, and associated taxes related to utility executives. The Company's adjustment to remove incentive compensation based on financial performance one piece of the adjustment to equitably share the costs of executive compensation between the Company and customers.

Q. PLEASE RESPOND TO WITNESS HAFEEZ'S CLAIM THAT ORS IS REACHING FOR AN ADJUSTMENT TO LOWER THE COMPANY'S REVENUE REQUIREMENT.

A. Witness Hafeez claims that ORS is "reaching to propose an unwarranted and arbitrary adjustment simply to lower KIU's revenue requirement in this application."¹⁹ It appears Witness Hafeez bases his claim on the fact that ORS did not propose an adjustment to remove 50% of the amounts related to base salary, benefits, and taxes for the four highest compensated SWWC executives in the recent rate case for KIU's sister utility, Palmetto Wastewater Reclamation, Inc. ("PWR") in Docket No. 2021-153-S. While a similar adjustment would have been appropriate for PWR, ORS did not make this recommendation, and, ultimately, the parties reached a partial stipulation on all issues except the appropriate rate of return, which was decided by the Commission.

The Company's claim indicates a fundamental lack of understanding of the unique role of ORS. ORS does not "reach" for ways to reduce the Company's requested revenue requirement. First, ORS reviews, examines, and audits the Company's Application to

¹⁹ Rebuttal Testimony of Mujeeb Hafeez p.9, ll.14-16

1 verify the accuracy of the information used in the ratemaking process. Second, ORS tests
2 the Company's expenditures to ensure the expenditures are prudent and that the Company's
3 assets are used and useful. Finally, ORS makes recommendations to establish just and
4 reasonable rates that represent the public interest.

5 **Q. PLEASE RESPOND TO WITNESS HAFEEZ'S ASSERTION THAT THE**
6 **ACTIVITIES OF THE CORPORATE DEVELOPMENT TEAM CREATE**
7 **QUANTIFIABLE NET BENEFITS TO CUSTOMERS.**

8 A. Although the Team was formed in 2015, this KIU rate proceeding is the first time
9 the Team's expenses have been requested for rate recovery in South Carolina by any
10 SWWC affiliate. Recently, in the PWR rate case heard by the Commission in 2021, PWR
11 did not request recovery of the allocated expenses of the Team. To support the Company's
12 assertion that the Team provides quantifiable benefits to KIU customers, Witness Hafeez
13 provides an incomplete picture of the costs and benefits related to the changes in the
14 SWWC overhead Three-Factor Allocation Methodology. Witness Hafeez is correct in that
15 the overhead cost allocation percentage for KIU decreased since the last rate case to 4.1%
16 (as reflected by ORS Witness Rabon's Direct Testimony). However, Witness Hafeez
17 incorrectly attributes the sole reason for the decrease in the overhead allocation to the
18 Team's activities growing the SWWC business footprint through various acquisitions since
19 the last KIU rate case. The Company allocates management fees and overhead costs
20 (including the Team's costs) using a Three-Factor Allocation Methodology which is based
21 on: (1) gross plant, (2) direct operating expenses, and (3) payroll. While acquisitions of
22 additional operating utilities may increase the pools of gross plant, direct operating
23 expenses, and payroll, acquisitions of utilities are not the only drivers of a change in the

1 allocation of overhead to or other subsidiaries of SWWC. For example, if KIU constructs
2 another \$10 million pipeline, the gross plant pool of costs upon which the Three-Factor
3 Allocation Methodology is based would be impacted and the overhead cost allocation to
4 KIU would increase if other factors such as acquisitions, direct operating expense and
5 payroll do not change. The Team's activities are not the only driver of the decrease in the
6 overhead allocation percentage to KIU, so the Company's assertion that the Team's
7 activities are the direct source of the decrease in allocation percentage is incorrect.

8 Witness Hafeez only provides the estimated savings based on the incorrect premise
9 that the decrease in overhead allocation to KIU is directly attributed to the activities of the
10 Team.²⁰ ORS's analysis of the information provided by the Company²¹ indicates that the
11 2017 SWWC Corporate Costs were \$13,403,864. In comparison, the 2020 SWWC
12 Corporate Costs increased to \$13,897,169. While the overall Corporate Costs increased by
13 4% since the last general rate case, the SWWC Corporate Cost allocation sought by KIU
14 increased from \$410,000 in 2017 to \$597,578 in 2020, which is a 16% increase. The
15 Company's Rebuttal Testimony justifying the \$46,930 cost of the Team does not reflect
16 the total impact of the SWWC management and overhead allocations on the rates requested
17 to be paid by KIU's customers in this case.

18 In summary, customers of KIU should not pay for the Company's acquisition
19 efforts including the personnel employed to seek out and evaluate new opportunities and
20 negotiate purchase agreements and utility acquisition closings. ORS's recommendation to
21 remove the expenses related to the Team is just and reasonable because the customers of

²⁰ Rebuttal Testimony of Mujeeb Hafeez p.11, ll.1-12

²¹ Company Response to ORS Request 2-18 in this Docket, and Company response to ORS Request 1-15 in Docket No. 2018-257-WS.

KIU would bear 100% of the costs and financial risks associated with the Company's speculative acquisition efforts. The allocation of expenses from SWWC to KIU for the Team are merger transaction costs and should be disallowed for ratemaking purposes. The Commission has historically prohibited the inclusion of merger transaction expenses in customers rates as a customer protection.

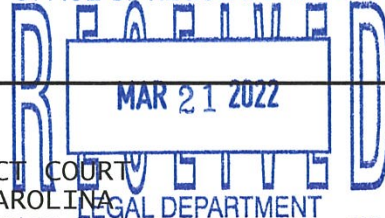
Q. WILL YOU UPDATE YOUR SURREBUTTAL TESTIMONY BASED ON INFORMATION THAT BECOMES AVAILABLE?

A. Yes. ORS reserves the right to revise its recommendations via supplemental testimony should new information not previously provided by the Company, or other sources become available.

Q. DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?

A. Yes, it does.

OFFICE OF REGULATORY STAFF



UNITED STATES DISTRICT COURT
DISTRICT OF SOUTH CAROLINA

* * * * *

MEARS GROUP, INC.

versus

KIAWAH ISLAND UTILITY, INC.

* * * * *

Case No. 2:17-cv-2418

January 16, 2019

REPORTER'S OFFICIAL TRANSCRIPT OF THE
MOTIONS FOR SUMMARY JUDGMENT HELD BEFORE THE
HONORABLE DAVID C. NORTON
UNITED STATES DISTRICT JUDGE
JANUARY 16, 2019

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Proceedings recorded by mechanical stenography using
computer-aided transcription software.

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(Call to order of the Court.)

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THE COURT: Take your seats. Thanks. Okay. Who's

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going first?

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MR. SCHWARTZ: Plaintiff, Your Honor.

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THE COURT: All right.

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MR. SCHWARTZ: Good afternoon. My name is Dick

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Schwartz, and we're here today on Cross-Motions for Summary

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Judgment. Plaintiffs filed a Motion for Summary Judgment. The

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defendants replied and then filed their own Cross-Motion for

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Summary Judgment.

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And the issue has to do with who had the burden

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to provide all risk, Builder's Risk insurance on a project

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involving horizontal directional drilling under the Kiawah

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River. We are past --

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THE COURT: Did Mears get Builder's Risk insurance?

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MR. SCHWARTZ: Sir?

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THE COURT: Did Mears get Builder's Risk insurance?

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MR. SCHWARTZ: Yes. Mears carries Builder's Risk

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insurance year round, so they don't go buy it. They have it.

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THE COURT: Okay.

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MR. SCHWARTZ: So it's just something they have

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22

anyway.

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THE COURT: Okay.

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MR. SCHWARTZ: Yes.

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THE COURT: Got it.

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1 MR. SCHWARTZ: They did not acquire it specifically
2 for this project.

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3 what we're asking Your Honor to do is to enter
4 an order declaring that under the plain language of the
5 contract, that KIU had the obligation to provide primary
6 Builder's Risk insurance on an all-risk form for the project
7 naming Mears as a loss payee, and that KIU breached the
8 contract by failing to provide such a policy.

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9 And I've prepared a PowerPoint which I hope will
10 be helpful to Your Honor, because what I'd like to do is really
11 walk through the key provisions of the contract with you so we
12 can articulate with the language of the agreement the reason we
13 believe Mears -- or rather KIU had that obligation.

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14 The things I want to address are these: That
15 only KIU was required to provide primary Builder's Risk
16 insurance. A lot of the discussion in the -- in KIU's papers
17 has to do with who was going to provide "the" Builder's Risk
18 insurance, but the issue has to do with "primary" Builder's
19 Risk insurance. And KIU's argument that the special condition
20 somehow relieved KIU of this obligation or that the general
21 conditions were superseded requires a rewriting of the
22 contract. And what we're going to see, Your Honor, is that the
23 parties used a form contract, and the form starts with the
24 premise that the owner provides the Builder's Risk insurance.
25 If the owner and contractor want to change that, the form

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1 provides a mechanism for doing it in the supplementary
2 conditions, and you delete and replace the part of the general
3 conditions with something in the supplementary conditions which
4 says, "Contractor is going to provide the insurance." That was
5 not done.

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6 The parties did agree to special conditions, but
7 the special conditions didn't delete or replace anything; just
8 added things, which left in place pages of the contract in the
9 general conditions relating to who had the obligation to
10 provide the primary Builder's Risk insurance.

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11 KIU does not dispute it did not provide the
12 Builder's Risk insurance, so if KIU had the obligation, as we
13 believe they did, then they breached the contract, and that's
14 the relief that we're seeking.

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15 I put up on the screen just an overview of the
16 area where this job took place. It just sort of puts things in
17 context. The crossing was actually a 7000-foot crossing, and
18 the things that have been written about it talk about it
19 stretching the capabilities of horizontal to directional
20 drilling technology and the experience of all the people
21 involved, and it was really record-breaking. They take -- they
22 drill this hole underneath the river, and then, you know, they
23 got to start on one side and get to the other side at the point
24 where they're supposed to be, and then you got to enlarge that
25 hole and pull pipe through it. And, of course, in this

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1 instance in the process of doing that, the pipe got stuck and
2 the hole had to be redone, which is the reason you have
3 Builder's Risk insurance.

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4 THE COURT: why would you need two Builder's Risk
5 policies? wouldn't they be duplicative?

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6 MR. SCHWARTZ: well, they might be, but it's really
7 not a question of whether they're needed or not, because people
8 -- like we maintain our insurance all the time, so you want to
9 be sure as in allocating the risk between the parties who's
10 going to have the primary policy or not.

11 THE COURT: so your policy that your client carries
12 all the time is sometimes primary and sometimes secondary?

13 MR. SCHWARTZ: Yes. Just depends on what's
14 negotiated between the parties in the contract.

15 THE COURT: And so once the parties have negotiated,
16 your client would go to its insurance carrier and say, "In this
17 project, it's primary. In this project, it's secondary," or do
18 they do that in that detail?

19 MR. SCHWARTZ: You would do that by way of an
20 endorsement, yes, Your Honor.

21 THE COURT: okay. And in this case, was there such
22 an endorsement?

23 MR. SCHWARTZ: There is not such an endorsement.

24 THE COURT: That's normal.

25 MR. SCHWARTZ: Okay. So I want --

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THE COURT: Nobody ever keeps the paperwork they're supposed to keep in these things.

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MR. SCHWARTZ: Sir?

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THE COURT: Nobody ever keeps the paperwork in these construction jobs.

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MR. SCHWARTZ: No, of course not.

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THE COURT: No certificates of insurance. No nothing.

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MR. SCHWARTZ: Right.

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THE COURT: Okay.

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MR. SCHWARTZ: And so --

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THE COURT: We have to make it all up.

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MR. SCHWARTZ: And, you know, KIU makes a big deal in their papers, and I'm sure you've read it, about we didn't ask for a certificate of insurance, and somehow that constitutes some kind of a waiver of KIU's obligation to provide the insurance at all. And it -- they're different things. KIU's breach can't be a waiver of their obligation to provide the insurance. But just as you've said, you know, we could have asked for the certificate, but we didn't, but that's all that amounts to is we didn't do the paperwork that we were -- that we could have done.

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So you have these three sections of the contract, Your Honor. You've got the form general conditions, the form supplementary conditions, and the special conditions.

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1 And this is what they call the EJCDC contract. And so the
2 standard general conditions appear like this. And this is the
3 provision relating to contractor's insurance. I have this on a
4 separate slide if this is not readable. Can you read it? I
5 can read it on mine.

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6 THE COURT: Oh, sure. I can read it.

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7 MR. SCHWARTZ: Okay. Very good. So it's important
8 to understand the way this is structured, because the -- this
9 provision with respect to contractor's insurance talks about
10 the insurance the contractor will purchase, and it must be
11 purchased before the inception of the job or maintain. And the
12 part I want to point out in particular here is clause
13 5.04(A)(5), because it -- this part about contractor's
14 insurance says the contractor is going to get insurance for
15 claims for damages other than to the work itself. And that's
16 important, because the work itself is what Builder's Risk
17 insurance covers.

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18 The next provision that I want to look at is
19 5.06, which is the property insurance. This is the one that
20 deals with the Builder's Risk insurance. And it says, "Unless
21 otherwise provided in the supplementary conditions, owner shall
22 purchase and maintain property insurance upon the work at the
23 site in the amount of the full replacement cost."

24 So 5.04 and 5.06 complement each other. 5.04
25 says that the contractor is not going to provide the insurance

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1 for the work, and 5.06 says that the owner is.

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2 And this insurance is supposed to do these
3 things. It's supposed to insure the interest of the owner and
4 the contractor, each of whom is deemed to be -- to have an
5 insurable interest and be listed as a loss payee; be written on
6 a Builder's Risk all-risk form that at least include insurance
7 for physical loss or damage to the work; include expenses
8 incurred in repair or replacement -- and include expenses in
9 repair or replacement.

10 Now, the primary -- the part in the contract
11 that talks about whether this insurance which the owner is to
12 provide is primary is in this section, Your Honor. It's in
13 5.07. It's under a section called "Waiver of Rights," and, you
14 know, why it's titled that, I don't know, but what it says is
15 that, "Owner and contractor intend that all policies purchased
16 in accordance with Paragraph 5.06," which is the property
17 insurance part, "will protect owner and contractor as loss
18 payees and will provide" -- and here's the key language --
19 "primary coverage for all losses and damages caused by the
20 perils or causes of loss covered thereby." This is the only
21 provision in the -- this whole contract that talks about whose
22 insurance will be primary, and it is the owner's insurance that
23 is to be primary.

24 So if you just look -- you start with the
25 general conditions, the conclusion is that the general

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1 conditions require the owner to provide the primary all-risk
2 Builder's Risk insurance, protecting the contractor, which is
3 the plaintiff here.

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4 Now, there were supplementary conditions, and
5 the supplementary conditions specifically say that they amend
6 or supplement the standard general conditions and other
7 provisions of the contract as indicated in the document itself.
8 It also says, "All provisions that are not so
9 amended or supplemented remain in full force and effect."
10 So did the supplemental conditions change any of
11 the obligations in the general conditions relating to the
12 owner's obligation to provide Builder's Risk? And the answer
13 is no.
14 There is a provision in SC-5.04, which you'll
15 remember relates to the contractor's obligation to buy
16 insurance -- that says that the contractor won't commence work
17 unless it has obtained certain insurances. And the contractor
18 agrees as a condition precedent to beginning the work that it
19 will maintain certain insurances. And I summarized what those
20 were, rather than include all the pages, but the insurance
21 requirements relate to commercial general liability insurance,
22 business, automobile, worker's comp, umbrella, and provide
23 evidence of insurance. So Builder's Risk or property is not
24 one of them. In fact, the supplementary conditions do not
25 mention articles 5.06 or 7 which provide for the owner's

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1 obligation to provide the primary Builder's Risk insurance.

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2 So again, the conclusion is that there's --

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3 there's no change to the general conditions.

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4 In addition, Your Honor, the people who do this

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5 form provide a guide to the preparation of the supplementary

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6 conditions. And the guide provides a mechanism for making the

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7 contractor provide for the Builder's Risk insurance. And it

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8 says if you want to do that, you don't want to use the standard

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9 conditions that we -- that's our default and you want to do it

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10 different, then if the contractor rather than the owner will

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11 purchase a Builder's Risk property insurance, use this in the

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12 supplementary conditions, and this is key. It says,

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13 "SC-5.06(A). Delete Paragraph 5.06(A) in its entirety and

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14 insert the following in its place. 'Contractor shall purchase

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15 and maintain property insurance.'"

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16 And the important thing here is that there's a

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17 way to do this if that's what the parties had intended. The

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18 form tells you how to do it, and nowhere in this contract was

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19 the general condition that the owner provide the insurance

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20 deleted and replaced like this.

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21 So the supplementary conditions didn't change

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22 the owner's obligation.

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23 Now, there were special conditions, and the

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24 special conditions did have a provision relating to Builder's

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25 Risk, and KIU asked that Mears provide a limited form of

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1 Builder's Risk insurance called fire and extended coverage, and
2 that's in special condition number 7 of the contract, but
3 you'll note there's nothing here that says anything about this
4 insurance being primary. It just says, "You will provide
5 this," which we did as a part of the coverage that, you know,
6 we keep all the time and have. So this special condition
7 didn't replace, modify, or eliminate the owner's obligations in
8 the general conditions. It didn't state that the contractor's
9 insurance would be primary, and it doesn't have any language in
10 there in any way that says that the owner is somehow relieved
11 of its obligation to provide primary Builder's Risk insurance.

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12 When the parties wanted to delete something or
13 modify a provision, they did it. So if you look at other
14 aspects of the supplementary conditions, for instance, then you
15 can see SC-2.07 said, "Delete items 1, 2, and 3," and I put
16 some examples in here. Supplementary conditions. This is how
17 the parties changed their contract. They said, "Delete items
18 1, 2 and 3," or they said, "Modify A to state that owner shall
19 notify contractor of any known encumbrances." There is no
20 language like this with respect to KIU's obligation, so the
21 special conditions didn't change KIU's duty to provide the
22 primary Builder's Risk insurance either.

23 What KIU is really asking the Court to do is to
24 add words to the contract, to rewrite the contract, and to
25 change the expressed intention of the parties to an unambiguous

1 : 49 PM 1 agreement. They're really asking you to disregard pages of the
1 : 49 PM 2 contract that provide that KIU as an owner had the obligation
1 : 50 PM 3 to provide the insurance.

1 : 50 PM 4 They say in their opposition that the standard
1 : 50 PM 5 general conditions require both KIU to obtain Builder's Risk
1 : 50 PM 6 and the special conditions requires Mears to do the same.
1 : 50 PM 7 There's no ambiguity. That's what the contract says, but
1 : 50 PM 8 there's only one provision relating to whose policy was going
1 : 50 PM 9 to be primary.

1 : 50 PM 10 Your Honor, the guiding principles with respect
1 : 50 PM 11 to contract interpretation really I think inform the decision
1 : 50 PM 12 in this case. In the *Progressive* case, the Court said if the
1 : 50 PM 13 language is plain, unambiguous and capable of only one
1 : 50 PM 14 reasonable interpretation, no construction is required, and the
1 : 50 PM 15 contract's language is determined by the instrument -- the
1 : 50 PM 16 contract language determines the instrument's force and effect.
1 : 50 PM 17 We don't think you need to construct the contract, because it's
1 : 50 PM 18 plain and unambiguous.

1 : 51 PM 19 The *Lee* case I think is -- may be particularly
1 : 51 PM 20 instructive. It says, "A Court's duty is limited to the
1 : 51 PM 21 interpretation of a contract made between the parties,
1 : 51 PM 22 regardless of its wisdom or folly, apparent unreasonableness,
1 : 51 PM 23 or the parties' failure to guard their rights carefully." And
1 : 51 PM 24 *Lee* involved a patron for the University of South Carolina who
1 : 51 PM 25 in exchange for providing a life insurance policy with the

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1 school as the beneficiary, received the right to purchase -- or
2 what they called in the contract the opportunity to purchase
3 tickets to the basketball and football games of the University.
4 And that's all it said. And the University decided that it
5 wasn't raising enough money, and so it added a requirement,
6 which was that the persons who bought the tickets had to buy a
7 license. And this patron said, "Well, that's not what our
8 contract said. Our contract said I'd have the opportunity to
9 buy the tickets." And the Supreme Court of South Carolina
10 agreed; in essence said that the University was attempting to
11 add something to the contract which did not exist, and that the
12 patron had the right to buy the tickets without paying the
13 license. And KIU is really trying to do the same thing.
14 They're trying to rewrite the contract and add something that
15 doesn't appear.

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16 The *Ecclesiastes* case said when interpreting a
17 contract, a Court must read the contract in its entirety, and
18 if reasonably possible, effect must be given to each clause so
19 that a Court will not find an interpretation which casts out or
20 disregards a meaningful part of the language of the writing,
21 unless no other course can be sensibly and reasonably followed.

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22 And *Ecclesiastes* involved an issue of the scope
23 of a release, and the allegation was that a party who was
24 already being sued as part of the arrangement in the case was
25 released under the scope of an agreement between two other

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1 : 53 PM 1 parties, and in order to come to that interpretation, the Court
1 : 53 PM 2 said you'd have to disregard multiple provisions of the
1 : 53 PM 3 contract that provided that the case would continue against
1 : 53 PM 4 that party and be vigorously pursued and that recovery would be
1 : 53 PM 5 conditioned on the payment of the settlement would be
1 : 53 PM 6 conditioned on that happening, so you have to disregard parts
1 : 53 PM 7 of the contract to reach that conclusion. Similarly what KIU
1 : 53 PM 8 is asking you to do is to disregard key provisions of the
1 : 53 PM 9 contract in order to get to the point that it wishes to be as
1 : 53 PM 10 not being required to provide the Builder's Risk insurance.

1 : 53 PM 11 This *Bank of Commerce v. Maryland* case is a
1 : 53 PM 12 similar case involving reading the contract as a whole and
1 : 53 PM 13 trying to construe things harmoniously and not making something
1 : 54 PM 14 nugatory, which is a word I had to look up. I didn't know what
1 : 54 PM 15 that means, but -- without meaning or effect. And so once
1 : 54 PM 16 again, we've given you a couple of examples of cases where the
1 : 54 PM 17 interpretation that is being advanced by KIU would render
1 : 54 PM 18 certain portions of the contract meaningless, and they can't
1 : 54 PM 19 all be read harmoniously together, because only one party had
1 : 54 PM 20 the obligation to provide primary insurance, and that was KIU.

1 : 54 PM 21 So the only interpretation that gives effect and
1 : 54 PM 22 meaning to all the clauses in the contract is the one that
1 : 54 PM 23 requires KIU to provide the Builder's Risk insurance.

1 : 54 PM 24 KIU has filed with its Motion for Summary
4 PM 25 Judgment and the response an email that had -- that was

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1 traced -- that was exchanged between the parties in connection
2 with the negotiation of the contract, but I don't think you
3 ever need to get there, Your Honor, because the contract is
4 unambiguous, and so it's extrinsic evidence which should not be
5 considered or admissible.

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6 They have offered the affidavit of two
7 individuals who didn't negotiate the contract as to what -- how
8 the contract should be interpreted, and we've objected to
9 that evidence on the basis that it's incompetent.

10 But in any event, the email doesn't contradict
11 the terms of the agreement anyhow, because Mears did agree to
12 provide Builder's Risk insurance, standard fire and extended
13 coverage, which is a limited coverage that covers eight things,
14 and they did that. So the email is not actually
15 inconsistent -- or the document is not actually inconsistent.

16 THE COURT: Doesn't the consideration of this
17 evidence deal with whether you use the South Carolina standard
18 for summary judgment or the Federal standard for summary
19 judgment?

20 MR. SCHWARTZ: What is the first part of your
21 question, Your Honor?

22 THE COURT: Whether the Court should consider this
23 evidence have to deal with -- or a function of whether we are
24 considering this -- these motions as South Carolina procedure
25 or the summary judgment of Federal procedure, because there's a

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1 lot of difference between the two.

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2 MR. SCHWARTZ: well, I think in terms of the

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3 extrinsic evidence, that if you have an unambiguous contract --

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4 THE COURT: Then you don't get there.

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5 MR. SCHWARTZ: -- you don't there.

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6 THE COURT: okay.

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7 MR. SCHWARTZ: That would be my response, yes, sir.

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8 So we get to the point then, Your Honor, which
9 is KIU's insurer, Westport, determined that their insurance was
10 excess, not primary. Even KIU's expert has said that the KIU
11 policy was excess and not primary. And so KIU did not comply
12 with the contract.

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13 And so we're asking the Court to grant summary
14 judgment under the plain language of the contract and enter a
15 an order that KIU had the obligation to provide primary
16 Builder's Risk insurance on an all-risk form naming Mears as a
17 loss payee, and KIU breached the contract by prevailing to --
18 by failing to do that.

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19 THE COURT: Okay. How about give me a copy of your
20 PowerPoint, because the -- my law clerk that did the memo for
21 me got so excited about this case, that she fell off the bench
22 and hurt her ankle, so she had to go to the doctor. She
23 also -- she also had an indemnity case earlier this morning,
24 and I told her if I had those two cases, I'd commit suicide, so
25 she just hurt herself.

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1:57 PM 1 MR. SCHWARTZ: That's quite understandable. We will
1:57 PM 2 gladly do that, Your Honor. I may have it on a thumb drive
1:57 PM 3 that only has that on it. Is that okay?
1:57 PM 4 THE COURT: That's fine. Or Mr. Wooten can get it to
1:57 PM 5 us, whichever way it is. And I guess if they want a copy of
1:57 PM 6 it --
1:57 PM 7 MR. SCHWARTZ: Oh, absolutely.
1:57 PM 8 THE COURT: Okay.
1:57 PM 9 MR. SCHWARTZ: Sure. Yes, sir. Thank -- any other
1:57 PM 10 questions, Your Honor?
1:57 PM 11 THE COURT: Not right now.
1:57 PM 12 MR. SCHWARTZ: Thank you, sir.
1:57 PM 13 THE COURT: Thank you, Mr. Schwartz.
1:58 PM 14 MR. WEATHERHOLTZ: Good afternoon, Your Honor. James
1:58 PM 15 Weatherholtz. I represent Defendant KIU in this case. And I'd
1:58 PM 16 like to start by just laying some foundation on two particular
1:58 PM 17 points and then step into our argument.
1:58 PM 18 Procedurally, the plaintiff in the case filed a
1:58 PM 19 Motion for Summary Judgment. We filed an opposition to that.
1:58 PM 20 We also filed our own Cross-Motion for Summary Judgment, as
1:58 PM 21 Mr. Schwartz said. I think for the sake of efficiency, I will
1:58 PM 22 probably address my opposition to plaintiff's motion at the
1:58 PM 23 same time I argue some of the points in our cross-motion.
1:58 PM 24 THE COURT: Sure.
1:58 PM 25 MR. WEATHERHOLTZ: Because, frankly, most of them are

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1 the same.

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2 THE COURT: They're all the same.

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3 MR. WEATHERHOLTZ: Yes, sir. Two foundational
4 points. The first is that I think it's important for the Court
5 to understand how this contract came together. As set forth in
6 the affidavit of Mr. Yodice with Thomas & Hutton, he's the
7 engineer. He put together these contract documents. He sent
8 them to KIU. KIU and Mears then traded copies of the contract
9 back and forth and negotiated certain points of it. What's
10 particularly important in all of that is that the standard
11 general conditions, this EJCDC, C-700 form document was in PDF
12 format only. So Mark Yodice says that all he had was a PDF.

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13 He also says that his practice in negotiating
14 and finalizing contracts like these is to take the standard
15 general conditions in PDF format and then modify those using
16 word versions, electronic word versions that can be edited
17 within the document for the supplementary conditions, which
18 we've talked about here today, and the special conditions. So
19 when I step into the argument and talk about the contract
20 interpretation and trying to reconcile these two provisions
21 about Builder's Risk insurance, I'm going to call back to the
22 fact that the parties in this case on both sides, none of the
23 parties had the opportunity or the ability to edit or change
24 the PDF except through the supplementary conditions and the
25 special conditions.

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1 And the second point I think goes right to the
2 heart of the plaintiff's argument about -- about the obligation
3 to provide primary insurance. Builder's Risk insurance, of
4 course, is insurance that exists over the life of construction,
5 over the course of construction of the project. So the
6 traditional example is a contractor is building a house. The
7 house catches on fire. It's halfway built. It burns to the
8 ground. The insurance steps in, pays the cost of building that
9 house back up to the halfway point so that neither the owner
10 nor the contractor has to suffer that loss. Keeps the project
11 on schedule.

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12 In a construction contract like this one, the
13 parties will negotiate. Okay, which party is responsible for
14 having the Builder's Risk insurance, either the owner or the
15 contractor? It doesn't make sense for both parties to have the
16 same insurance, so I think the discussion here today about the
17 primary obligation is somewhat of a diversion, because it's not
18 logical for both sides to have the same insurance, because the
19 loss can only be paid once. The claim can only be paid one
20 time.

21 Now, there are situations in which a policy in a
22 Builder's Risk situation might be primary over another policy.
23 This comes from Paragraph 13 of the Rakich affidavit, and the
24 idea is this. There are some projects out there that are so
25 big that one insurance company is not willing to give a

2:01 PM 1 Builder's Risk policy for the entire amount. If it's a \$100
2:01 PM 2 million courthouse that is being built, one carrier might offer
2:01 PM 3 \$50 million, and another carrier might offer another 50. In a
2:01 PM 4 situation like that, then the contract needs to be explicit
2:01 PM 5 about which policy is primary.

2:01 PM 6 The plaintiff in this case has made the argument
2:01 PM 7 that there is a difference, a distinction between the type of
2:01 PM 8 insurance that Mears was supposed to provide versus the type
2:02 PM 9 that KIU was supposed to provide. And the argument basically
2:02 PM 10 is that under the standard general conditions, the owner had to
2:02 PM 11 provide an all-risk policy. And in the insurance world, that
2:02 PM 12 means coverage for all risks. Their argument is that Mears in
2:02 PM 13 the special conditions was only responsible for providing a
2:02 PM 14 limited subset of insurance, and they call it fire and extended
2:02 PM 15 coverage. We disagree with that interpretation of the language
2:02 PM 16 of the contract. I think SC-7 within the special conditions
2:02 PM 17 states pretty clearly that, "Mears has the obligation to
2:02 PM 18 provide Builder's Risk insurance." There's an open paren,
2:02 PM 19 "including fire and extended coverage." Now "including" is a
2:02 PM 20 word that I added, but that's our interpretation, is that the
2:02 PM 21 contract shifted, the special conditions shifted the burden
2:02 PM 22 from KIU to Mears to provide all the Builder's Risk insurance.

2:03 PM 23 THE COURT: Because under the contract itself,
2:03 PM 24 without the supplementary conditions, your client had the
2:03 PM 25 responsibility to buy Builder's Risk primary insurance; right?

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MR. WEATHERHOLTZ: Without the supplementary and the special conditions, we did have the obligation, and there is a conflict. Now getting into this argument about whether the contract --

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THE COURT: Well, it may be a conflict, but there may be -- might be better to say it is a modification.

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MR. WEATHERHOLTZ: Well, right. They have to be

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reconciled in some way, and the way that we argue they need to

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be reconciled is that the more specific provision, which is the

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special conditions, that that takes precedence over the

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standard general conditions.

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And I think even if you accept their argument

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that they only had the obligation to provide a limited subset,

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it's still duplicative. They are still being asked, at least

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under their interpretation, to go out and purchase or provide

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insurance that is the same as the insurance that under their

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interpretation the owner was supposed to provide.

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THE COURT: But the cost of the insurance, if it's

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primary or secondary makes a great deal of difference to the

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insurance company. If they've got a \$10 million cushion, they

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charge them a lot less premiums if they've got from 10 million

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to 20 million; right?

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MR. WEATHERHOLTZ: Yes, but it was only a \$5 million

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project, so I would say that --

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THE COURT: It's just money; all right?

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1 MR. WEATHERHOLTZ: Right, right. But there was never
2 any discussion, and it's not in the record --

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3 THE COURT: So how is there a \$7 million loss on a \$5
4 million project?

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5 MR. WEATHERHOLTZ: That's a good question.

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6 THE COURT: How about a good answer?

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7 MR. WEATHERHOLTZ: Well, we're trying to figure that
8 out.

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9 THE COURT: Okay.

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10 MR. WEATHERHOLTZ: It was a \$5 million project start
11 to finish, and they've made a claim for \$7 million to replace a
12 portion of the pipe, and I see the numbers, but I can't give
13 you a good explanation for how it got that high.

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14 THE COURT: Well, they were \$2 million in before it
15 went down the tubes, and then said it's \$5 million more
16 probably, but I don't know.

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17 MR. WEATHERHOLTZ: Maybe, but certainly that's part
18 of what we will look at in discovery.

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19 So our first argument is that the contract is
20 not ambiguous; that these two provisions, they conflict. Both
21 parties should not and weren't contemplated to provide
22 Builder's Risk insurance in the same type of coverage, and it's
23 clear, I think. I don't think there's any dispute about the
24 fact that the special conditions are specific to this project.
25 They have project-specific information on the length of the

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1 pipe, the amount of liquidated damages, the duration of the
2 project. I mean, it is clear --

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3 THE COURT: Starting time.

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4 MR. WEATHERHOLTZ: Exactly. Yes, sir.

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5 THE COURT: Any other special conditions which
6 completely negate the general conditions other than this one?

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7 MR. WEATHERHOLTZ: That completely negate? No, sir.

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8 There are places in the special conditions that refer to the

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9 standard general conditions and say, "We are altering this

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10 section of the standard general conditions," but there is

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11 nothing in the special conditions that negates all that.

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12 THE COURT: Okay. And do you agree with the
13 observation that your client did not comply with the guide to
14 preparation of supplemental conditions, specifically
15 SC-5.06(A)?

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16 MR. WEATHERHOLTZ: I do, and here's why. That

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17 standard --

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18 THE COURT: You agree with that; right?

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19 MR. WEATHERHOLTZ: I do. Yes, sir. Well, I will put
20 it this way. The special conditions modify both the
21 supplementary conditions and the standard general conditions.
22 If you look at special condition 7, it talks about contractors'
23 and subcontractors' insurance obligations. This is the place
24 in the contract where the parties are saying, "Okay. This is
25 the insurance that Mears will provide." It lists Builder's

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2:06PM 1 Risk insurance under A. Under B it talks about providing proof
2:06PM 2 of insurance, and under C it says, "Other insurance
2:06PM 3 requirements are listed in the supplementary conditions." so
2:06PM 4 the special conditions modify the supplementary conditions,
2:06PM 5 which modify the standard general conditions, and in that way,
2:06PM 6 I would say the parties did comply. The parties did modify the
2:06PM 7 standard general conditions through these other two documents.

2:06PM 8 THE COURT: But they didn't use the language that was
2:06PM 9 outlined 5.06(A); right?

2:06PM 10 MR. WEATHERHOLTZ: No, sir. That is correct. They
2:06PM 11 did not choose to use the language offered in the supplementary
2:06PM 12 conditions to do that. They did it in another way. They did
2:06PM 13 it through the special conditions.

2:06PM 14 So that's our argument on the fact that it's not
2:06PM 15 ambiguous. We believe that the Court can apply standard
2:07PM 16 principles of contract interpretation and resolve the conflict
2:07PM 17 between those two provisions by saying that the more specific
2:07PM 18 provision controls, and that's what we would ask the Court to
2:07PM 19 do, both in opposition to plaintiff's Motion and in support of
2:07PM 20 our own Cross-Motion for Summary Judgment.

2:07PM 21 If the Court is not in a position to find that this
2:07PM 22 contract read as a whole is not ambiguous -- if the Court finds
2:07PM 23 that it is ambiguous, then we have offered extrinsic evidence
2:07PM 24 that we believe makes crystal clear the intentions of the
2:07PM 25 parties in this case. And I really just want to point out --

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THE COURT: Of course, extrinsic evidence hasn't been submitted on the other side, so I don't see how I could grant summary judgment to your client based on one side's extrinsic evidence.

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MR. WEATHERHOLTZ: I would say that may be true if we hadn't filed a Cross-Motion for Summary Judgment. If we were only opposing their motion, perhaps I would agree with that.

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But when we file our own affirmative Motion for Summary Judgment and we present that evidence, I think that the plaintiff has an obligation to counter that evidence and not merely rest on the hope that the Court will find it not ambiguous. That would be my position.

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The evidence I want to point to is first the Mark Yodice affidavit. Again, he's the engineer who put together the contract documents. Paragraphs 14 through 16 of his affidavit make it very clear that he believed that Mears had the obligation to provide the Builder's Risk insurance on this project.

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And I understand the point that they're making in the brief, and I heard Mr. Schwartz refer to it today, that they are challenging his ability to issue an opinion from a legal perspective about which party had the duty or the obligation under the contract, and I think his affidavit is clear that he's not doing that.

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what I would ask the Court to do is note the

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1 factual statements in his affidavit, paragraphs 14 through 16,
2 that one, he thought Mears was supplying the insurance here;
3 and two, that it's his standard practice not to edit the
4 standard general conditions, but to alter that document through
5 the other two, which as I have explained, that's what the
6 parties did here.

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7 Part of what Mr. Yodice's affidavit and his
8 factual statement is based on is this comment in the proposed
9 contract changes document that was passed back and forth
10 between Mears and KIU. And I think this is one of those
11 situations where understanding the context is helpful. I think
12 that the background for this is in Mr. Yodice's affidavit, but
13 for purposes of everybody in the room fully understanding our
14 position here today, once this proposed contract came from KIU
15 to Mears, Mears and its team put together a document. They
16 called it "Proposed Contract Changes", and they listed a number
17 of items where they said, "We would like these changes to be
18 made to the contract." KIU took that document and responded to
19 it. There were certain situations or certain items where they
20 said, "Okay. We agree. We'll accept that change." There were
21 others where they said, "No, we can't agree."

22 In response to one of those items where KIU
23 said, "We don't agree," Mears, through one of its
24 representatives, entered a comment in the margin, and the
25 comment says explicitly, "We are providing Builder's Risk

2:10PM 1 insurance on this project."

2:10PM 2 In terms of extrinsic evidence and the
2:10PM 3 intentions of the parties and evidencing or demonstrating what
2:10PM 4 Mears understood the agreement to be, to me, that is the piece
2:10PM 5 of evidence in the case that the Court or the finder of fact
2:10PM 6 could rely on to conclude that that was the intention of the
2:10PM 7 parties.

2:10PM 8 THE COURT: Okay. And you would say that to the
2:10PM 9 jury, and, of course, Mr. Schwartz would say, "It doesn't say
2:10PM 10 primary Builder's Risk insurance. It just says Builder's Risk
2:10PM 11 insurance, and what we meant when we said that is it's
2:10PM 12 secondary."

2:10PM 13 MR. WEATHERHOLTZ: That's possible.

2:10PM 14 THE COURT: There seems to be a genuine issue of
2:10PM 15 material fact.

2:10PM 16 MR. WEATHERHOLTZ: Well, except when you get to this
2:11PM 17 next piece of evidence. I would say maybe that piece of
2:11PM 18 evidence standing alone would be enough, but after that, after
2:11PM 19 the contract was signed, Mears submitted a certificate of
2:11PM 20 insurance. And if you go back to the special conditions and
2:11PM 21 this special condition 7, subparagraph B says that, "The
2:11PM 22 contractor shall furnish the owner with certificates showing
2:11PM 23 the type, amount, class of operations, effective dates, and
2:11PM 24 date of expiration of policies." The first paragraph says
2:11PM 25 that, "The contractor shall not commence work under this

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1 contract until obtaining the insurance required under this
2 paragraph and such insurance has been accepted by the owner."
3 well, contract is signed, the work is almost about to begin in
4 March of the next year. Mears sends an email to the engineer
5 providing the very evidence of insurance that we're talking
6 about here. And the email came from a guy named Scott Kehrer,
7 who's with Mears Group, and along with the email came a
8 certificate of insurance that had some additional insured
9 language, and then also a summary page of all the insurance
10 that's being provided pursuant to the requirements in the
11 contract.

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12 I would call the Court's attention to the
13 Certificate of Liability Insurance that was attached to that
14 email. First, it lists Builder's Risk insurance, the policy.
15 It names this project specifically. I mean, it says, "Kiawah
16 Island Project" under the description of operations section of
17 that paragraph. And for the Court's assistance, this is an
18 exhibit to Mark Yodice's affidavit. It's actually Exhibit 2 to
19 Mark Yodice's affidavit, and the certificate is on page 7 of
20 Exhibit 2.

21 If you flip over to page 8, the second page of
22 that certificate, it says, "Additional insured in favor of
23 Kiawah Island Utility, Inc."

24 And then when you flip over to the third page,
25 it has a summary of the insurances. It lists this Builder's

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1 Risk insurance policy. There's a \$75 million limit. There's
2 no indication there that this only fire or extended coverage.
3 There's no exception or endorsement that makes clear to the
4 parties that this is secondary insurance. This is simply their
5 proffer of insurance evidence in accordance with the contract.

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6 On the flip side of that, Mears has not
7 presented any evidence to date that KIU ever intended to or did
8 provide or even any evidence that it thought it had the
9 obligation to provide the insurance. I mean, we admit we
10 didn't go out and buy a Builder's Risk insurance policy for
11 this project, because our position is that the contractor had
12 that obligation.

13 There is a provision in the contract that says
14 if -- that both parties need to provide proof of insurance to
15 the other. And we did make a waiver argument. I won't belabor
16 that point here today. I think that I said everything in the
17 brief that we would say on that argument, but the fact that
18 Mears didn't call out the lack of insurance or go to KIU and
19 say, "Hey, guys. You were supposed to buy Builder's Risk
20 insurance. It's important. You haven't done it. We need to
21 see the evidence of that." Even if the Court doesn't find that
22 that's a waiver, to me that's further extrinsic evidence of the
23 fact that Mears didn't expect it. They weren't anticipating
24 it, and that's because they believed they had the obligation to
25 provide it under the contract.

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1 Mr. Schwartz made one point that I would like to
2 respond to directly. He argued that there is a letter from
3 Westport, and Westport is the property insurance carrier for
4 KIU, and when this issue popped up, KIU said, "We didn't buy a
5 Builder's Risk insurance policy, but we do have a property
6 policy, and it has some Builder's Risk coverage. In good
7 faith, we dispute and we disagree that we had the obligation,
8 but we're going to submit it to our carrier and see what they
9 say." They did issue a denial letter in part based on their
10 finding that this insurance was excess, but that goes right
11 back to the contract. They basically took the contract. They
12 interpreted it. They went to the special conditions. They
13 concluded that Mears was the party that had the obligation to
14 provide the insurance, and they denied the claim on that basis.

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15 They also denied the claim on the basis that it
16 was faulty workmanship, and that Mears had just drilled the
17 hole too small the first time. They drilled the hole larger
18 the second time. They were able to pull the pipe through. So
19 there were multiple grounds on which that claim was denied.

20 I think this is a situation frankly where it was
21 clear to the parties who were involved at the time they
22 contracted on who was supposed to provide the insurance. This
23 accident happened in -- at the end of June and in July of 2016.
24 I think that Mears went back and looked at the contract to
25 figure out what the insurance situation was, and they saw that

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1 this language had been left in there.

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2 Again, this was a PDF that was uneditable, so
3 you couldn't go in there electronically and strike that
4 language. I think that they saw that language in there, and
5 they just took the opportunity to try to shift this loss to the
6 owner through a breach of contract claim when, in fact, they
7 had the insurance all along. They provided evidence of having
8 the insurance. They argued that this claim would be covered
9 under their own insurance, and despite our demands that they do
10 it, they won't submit it to their own carrier for a decision.

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11 THE COURT: Okay.

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12 MR. WEATHERHOLTZ: And that's all I have in response
13 and in support of our Motion. I would reserve the right, just
14 because we filed a Cross-Motion, to reply to anything that
15 Mr. Schwartz may say --

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16 THE COURT: No problem.

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17 MR. WEATHERHOLTZ: -- but that's it for now. Thank
18 you, Judge.

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19 THE COURT: Okay. Mr. Schwartz?

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20 MR. SCHWARTZ: Thank you, Your Honor.

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21 Mr. Weatherholtz makes the argument that it makes no sense to
22 have two policies. We always have two policies, because we
23 carry -- Mears carries a policy all the time. And so it's
24 important that the contract between the parties delineate whose
25 insurance is primary. And this contract unambiguously provided

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1 that KIU's policy would be primary. That solves the problem.

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2 Even if it didn't make sense, which I don't
3 think Your Honor ever has to get to, the *Lee* case and other
4 cases have clearly enunciated that it doesn't matter whether it
5 makes sense. The Court says, "A Court must enforce an
6 unambiguous contract according to its terms regardless of its
7 wisdom or folly, apparent unreasonableness, or the parties'
8 failure to guard their rights carefully."

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9 Now, we believe the parties guarded their rights
10 carefully, because it's an extensive contract which was
11 reviewed by lawyers and signed by the parties, but it's not for
12 the Court to decide does this make sense. The issue is did the
13 contract provide for primary insurance, and who was going to
14 carry it, and there's only one provision in the contract about
15 that, and that is the provision that requires KIU to provide
16 that insurance.

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17 I think Mr. Weatherholtz's argument is
18 fundamentally premised on a mistaken basis. His argument is
19 that the provisions of the contract contradict each other, and
20 he said that the special conditions take precedence over the
21 general conditions, but if you read the special conditions,
22 they don't say that. Now, remember that the supplementary
23 conditions had the paragraph that said, "These conditions
24 modify or amend the general conditions." And I'm not saying at
25 all that these special conditions don't change the contract,

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1 but they do not say that they're changing -- that they're
2 replacing any provisions or deleting any provisions or
3 superseding or relieving the owner of its obligation to buy the
4 insurance. And so fundamentally the idea that these two
5 pieces -- the special conditions and the general conditions --
6 conflict is mistaken.

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7 And that's why we don't believe, Your Honor,
8 that there actually is a fact issue that either of us need to
9 get up before a jury and say, "well, we meant this, and you
10 meant that," because there's really only one reasonable
11 interpretation of the contract as a whole.

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12 with respect -- I already addressed the best
13 email. It was an exchange between the parties during course of
14 negotiation. It's not part -- it is not part of the contract,
15 and if Your Honor believes as we do that the contract is
16 unambiguous, you never reach that question.

17 I believe that's all I have, unless Your Honor
18 has any questions.

19 THE COURT: Thank you, Mr. Schwartz.

20 MR. SCHWARTZ: Thank you very much.

21 THE COURT: Mr. Weatherholtz?

22 MR. WEATHERHOLTZ: Your Honor, I do have two very
23 brief points. The first is that I do want to address this
24 issue about South Carolina law versus Federal law. This is a
25 Motion for Summary Judgment, so it's procedural. I think

2:20 PM 1 Federal law would apply.

2:20 PM 2 I think -- well, there are cases in the Fourth
2:20 PM 3 Circuit that address this question directly about if a Court
2:20 PM 4 sitting in diversity jurisdiction on a question of declaratory
2:20 PM 5 judgment interpreting a contract, if a Court is presented with
2:20 PM 6 a question about whether the contract is ambiguous, even if it
2:20 PM 7 finds that the contract is ambiguous and even if it does take
2:20 PM 8 into account extrinsic evidence, if there is still no genuine
2:20 PM 9 issue of material fact, the Court can grant a motion for
2:20 PM 10 summary judgment under those circumstances.

2:20 PM 11 I would disagree with the interpretation that --
2:20 PM 12 of the *Lee* case, that the Court can apply those two provisions
2:21 PM 13 even if they are in conflict or unreasonable. I don't think
2:21 PM 14 that unreasonable is a part of the standard. I think that the
2:21 PM 15 Court has to apply logic and reason to the question about
2:21 PM 16 whether or not those provisions are in conflict, and if because
2:21 PM 17 of that it finds that -- that it is not ambiguous, then it has
2:21 PM 18 to try to reconcile that.

2:21 PM 19 THE COURT: Okay. Thank you.

2:21 PM 20 MR. WEATHERHOLTZ: Thank you, Your Honor.

2:21 PM 21 THE COURT: Okay. Well, as soon as my law clerk gets
2:21 PM 22 back from the emergency room, we'll start working on it, and
2:21 PM 23 we'll let you know.

2:21 PM 24 MR. GIBSON: You might want to give her the day off,
2:21 PM 25 Your Honor.

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THE COURT: She's playing hurt.

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MR. GIBSON: Thank you, Judge.

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THE COURT: You're welcome.

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CERTIFICATE

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I, Tana J. Hess, CCR, FCRR, Official Court Reporter
for the United States District Court, District of South
Carolina, certify that the foregoing is a true and correct
transcript, to the best of my ability and understanding, from
the record of proceedings in the above-entitled matter.

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Tana J. Hess, CRR, FCRR, RMR
Official Court Reporter